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CFTC Commissioner: Code Developers May be Accountable for Smart Contracts

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Recently at a conference in Dubai, Brian Quintenz, who is a Commodity Futures Trading Commission (CFTC) Commissioner, expressed his personal opinion (rather than the views of the CFTC) on the conceptual challenges in applying the CFTC's regulatory oversight to, and fostering accountability for, smart contracts that reside on decentralized blockchains. In particular, Quintenz conveyed his belief that smart contract developers could potentially be held liable for aiding and abetting activity that violates CFTC regulations through the use of a smart contract that they programmed, if they "could reasonably foresee, at the time they created the code, that it would likely be used by U.S. persons in a manner violative of CFTC regulations."

At a high level, a smart contract is computer code encoded on a blockchain that is programmed to automate the execution of a transaction upon the occurrence of a triggering event. The CFTC regulates the U.S. derivatives markets and thus has oversight authority over futures and swaps markets, including derivatives on commodity cryptocurrencies. Among the many potential applications of smart contracts, Quintenz identified as a regulatory concern the ability of smart contracts to emulate traditional financial products, such as binary options or derivative contracts. For example, through a smart contract on a blockchain, one could bet on the outcome of a sporting event and, if the prediction is correct, the smart contract could be programmed to automatically settle the bet using a cryptocurrency transfer without the involvement of an intermediary. Applications such as this, Quintenz stated, resemble "prediction markets" and "event contracts," which may fall within the CFTC's purview and raise regulatory issues.

Quintenz sought to address who should be held accountable if a prediction market smart contract were to exist and violate a CFTC regulation. Rather than advocating to assign liability to the users of the smart contract, the core developers of the underlying blockchain or the miners that validate transactions on the blockchain, Quintenz suggested that the developers of the smart contract itself could be held accountable for having aided and abetted violations of CFTC regulations if they could reasonably foresee that the smart contract would likely facilitate those violations.

Acknowledging the novel legal issues raised by this new technology, Quintenz noted that the CFTC staff is open to engaging with innovators in the blockchain space, including smart contract coders, to understand the underlying technology and to work toward ensuring that the use of smart contracts is compliant with the law. “[It] may be that new products require the Commission to rethink its existing regulations or provide regulatory relief,” Quintenz said. He expressed an interest in these novel issues being considered by the LabCFTC group, which is the CFTC’s initiative to promote responsible FinTech innovation and fair competition, in part by creating a platform for FinTech innovators to inform the CFTC’s understanding of new technologies.

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